

ICPS newsletter[®]

Ukraine's economy in 2005: What's better now?

Lately, the media have been widely publishing opinions on the development of Ukraine's economy that describe 2005 as the year of collapse and predict the emergence of a widespread economic crisis. The figures presented in these articles are often wrong, interpreted one-sidedly, or deliberately distorted. This kind of biased reporting is having a negative impact on public opinion, as well as on the mood among businesses. ICPS economists have therefore summarized the most important achievements in Ukraine's economy this past year

Despite a slowdown in Ukraine's GDP growth from 12.1% in 2004 to 2.6% in 2005, last year was remarkable for a slew of positive economic trends. If these trends continue in the upcoming year, economic growth will pick up again.

Inflation slowed down. Whereas at the start of 2005, the CPI was moving up more than 14% on an annual basis, by the end of the year, it was only 10.3%. Producer prices did even better, growing 9.5% for the year. They rose only 8.1% on an annual basis in February 2006. This is nearly three times less than in 2004, when the PPI rose 24.1%.

Inflows of foreign capital picked up. 2005 was a record year for FDI, which totalled US \$7.3bn. In October 2005, KryvorizhStal, the country's largest steelworks, sold for a record US \$4.8bn. The banking sector saw significant inflows of FDI as investors snapped up Aval Bank and began to negotiate to buy UkrSibBank and Mria Bank. This should help bring interest rates down and introduce new banking technologies in Ukraine.

Ukrainian banks expanded their lending. In 2005 alone, credit portfolios grew 61.9% to UAH 143bn. Another positive trend is the expansion of long-term credits to 61.8% of all lending, compared to only 54.2% in 2005.

Monetary indicators improved. NBU reserves nearly doubled, to US \$19.4bn

as of 1 January 2006. The value of the hryvnia rose a total of 4.8% against the US dollar over the year.

Real disposable incomes grew. Even after inflation, household incomes grew 20.1%. Real wages grew 11.7%, while social benefits grew 41.5%. Wages grew for three main reasons:

- the minimum wage grew 40% over the year and public sector wages were raised across the board;
- unemployment began to approach its natural levels. Despite the slowdown in economic growth, wages continued to grow rapidly in all sectors. This could be a reflection of growing competition for workers;
- the consumer boom led to noticeable growth in both wholesale and retail trade and in the service sector. As a result, the nominal wages of workers in these sectors also grew: 40.2% in trade and 55.1% in services over the year.

More wage arrears were paid out. All sectors saw wage arrears shrink over the year. At the beginning of 2006, the total amount had shrunk 14% to UAH 959.7mn.

Private consumption grew at a record pace. Real household consumption grew 15.9% in 2005, spurred by:

- the steep rise in household incomes, especially those below-average, thanks to growing social benefits;

- a high propensity to consume, with consumers spending up to 90% of their incomes in 2006, compared to 87.5% in 2005, according to ICPS.

Retail sales grew nearly a quarter. Real retail trade turnover grew 23% over 2005. The quality of services also improved: the share of unofficial markets has continued to shrink and the number of stores and kiosks is now three times more than in 1999.

Unemployment shrank. In Q3'05, the unemployment level as calculated using ILO methodology, fell to a record-low 5.2%. In 2004, average unemployment was 8.6%.

Consolidated Budget revenues grew significantly. In 2004, these revenues represented 26.5% of GDP, whereas in 2005, they were 31.7% of GDP. This increase in revenues was due to:

- the shutting down of corrupt schemes for illegal VAT reimbursements. This led to higher VAT receipts;
- stronger customs oversight as a result of the "STOP Smuggling" program;
- the cancellation of special tax regimes for companies working in SEZs and TPDs;
- the withdrawal of tax holidays from the car-making, shipbuilding and aircraft manufacturing and space sectors.

The sharp increase in tax receipts led to a major reduction in the Consolidated Budget deficit, which went from 3.2% in 2004 to 1.8% in 2005. 92% of the deficit was covered by privatization revenues.

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Consensus forecast for 2006 is downgraded

quarterly predictions' economists participated in the latest macroeconomic forecast seminar 10 March 2006, organized by the Ministry of Economy with the support of the UN Development Programme (UNDP). Indicators in the consensus forecast are based on the average indicator in the outlooks presented by 11 government, NGO and international economists who participated in the seminar.

According to the consensus forecast, Ukraine's economy is likely to grow only 2.1%, rather than the 5.2% that was expected during the previous seminar in

October 2005. The Consumer Price Index is expected to rise another 2.4 pp to 12.6%. The Budget deficit for 2006 will be 2.2%, according to the expert group. The hryvnia exchange rate will slip to UAH 5.12/USD by the end of 2006. The outlook for GDP growth was downgraded because of lowered expectations of investment growth and expectations of a growing negative balance of trade.

In 2007, Ukraine's economy should grow 4.5%, inflation 10.8%, and the hryvnia should slip further, to UAH 5.17/USD. The trend for imports to grow faster than exports will continue. The Budget

deficit will fall to 1.6%. NBU gold and currency reserves will grow steadily. The average salary will grow to UAH 1,194 per month. ■

More detailed information about this quarterly seminar on the macroeconomic outlook (in Ukrainian) can be found on the Economy Ministry's website at <http://me.km.gov.ua> in the section called "Economic situation and forecasts." These regular macroeconomic consensus forecast seminars were started in 2002. For additional information, contact Yevhenia Akhtryko by phone at (380-44) 484-4403 or by e-mail at eahtryko@icps.kiev.ua.

Macroeconomic forecast for 2006–2007

Index	2006		2007	Index	2006		2007
	Forecast	October 2005 forecast			Forecast	Forecast	
Real sector	(mn UAH)			Import volumes	52.3	49.7	↑ 50.9
Nominal GDP	480,632	490,895	↓ 555,466	Revenue balance	-1.0	-1.0	= -0.6
Consumption	395,432	387,052	↑ 461,128	Official transfers (net)	3.2	2.8	↑ 3.0
private	304,459	297,627	↑ 353,722	Capital account balance	1.8	0.5	↑ 2.3
public	94,777	92,808	↑ 108,403	FDI	2.8	2.4	↑ 2.6
Investment	103,829	98,895	↑ 122,956	Exchange rate, UAH/USD	UAH/\$		
Gross accumulation of fixed capital	98,735	97,445	↑ 120,122	average	5.11	5.13	↓ 5.15
private	83,667	86,371	↓ 99,556	YE	5.12	5.11	↑ 5.17
public	15,081	14,017	↑ 17,694	Public finance	(mn UAH)		
Net export of goods and non-agency services	-16,144	-3,354	↓ -24,830	Total revenues	151,617	154,348	↓ 176,551
Gross national savings	106,653	112,661	↓ 121,778	Total expenditures	162,347	164,304	↓ 185,374
Real sector	(index, year-on-year)			Overall balance	-10,730	-9,956	↓ -8,824
Real GDP	102.1	105.2	↓ 104.5	<i>Financing items</i>			
Consumption	106.0	107.3	↓ 105.0	Privatization	5,093	5,304	↓ 4,476
private	107.1	108.8	↓ 106.9	Domestic borrowing	2,813	1,052	↑ 1,887
public	103.7	105.2	↓ 102.8	Foreign borrowing	957	1,474	↓ 1,347
Investment	103.3	106.8	↓ 106.7	Public finance	(% of GDP)		
Gross national savings	103.6	109.4	↓ 106.7	Total revenues	31.5	31.4	↑ 31.8
Inflation	(index, year-on-year)			Total expenditures	33.8	33.5	↑ 33.4
GDP Deflator (average annual)	113.9	111.4	↑ 111.0	Overall balance	-2.2	-2.0	↓ -1.6
CPI (average annual)	111.9	111.5	↑ 110.8	<i>Financing items</i>			
Dec. on Dec.	112.6	110.2	↑ 110.5	Privatization	1.1	1.1	= 0.8
PPI (average annual)	114.4	112.1	↑ 112.5	Domestic borrowing	0.6	0.2	↑ 0.3
Dec. on Dec.	114.7	112.1	↑ 111.7	Foreign borrowing	0.2	0.3	↓ 0.2
External Sector	(mn USD)			Money and credit	(mn UAH)		
Current account balance	-1,686	587	↓ -2,717	Monetary base			
Export volumes	45,508	46,419	↓ 49,606	YE	107,767	90,843	↑ 135,425
Import volumes	49,176	47,578	↑ 54,945	Dec. on Dec., %	30.2	21.3	↑ 25.7
Revenue balance	-987	-958	↓ -599	Money supply (M3)	255,615	198,344	↑ 335,123
Official transfers (net)	2,970	2,705	↑ 3,220	Dec. on Dec., %	31.7	25.4	↑ 31.1
Capital account balance	1,714	469	↑ 2,438	Average weighted interest rate on commercial hryvnia loans, % pa	16.0	14.3	↑ 14.8
FDI	2,614	2,264	↑ 2,786	NBU international reserves, mn USD	19,899	17,933	↑ 21,706
External Sector	(% of GDP)			Social indicators			
Current account balance	-1.8	0.6	↓ -2.5	Population, millions	46.7	46.7	= 46.3
Export volumes	48.4	48.5	↓ 46.0	Average wage, UAH	1,000.0	983.2	↑ 1,194.0
				Disposable household income, % change over previous year	6.1	6.9	↓ 6.8

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